

## **CHAPTER 13: OTHER SPECIAL CASES**

### ***[7 CFR 3560.458-459]***

#### **13.1 INTRODUCTION**

There are a number of special circumstances that necessitate additional servicing procedures beyond those presented in previous chapters. Most of these cases involve characteristics unique to either a particular property or to a particular borrower. Property and borrower issues include a number of relatively uncommon, but nevertheless important, situations that Loan Servicers need to know how to address. Property issues include abandonment, valueless liens, and other security issues. Borrower issues include death, divorce, bankruptcy/insolvency, and membership liability agreements.

This chapter presents the requirements for these other special servicing cases and Agency procedures for addressing them.

### **SECTION 1: PROPERTY ISSUES**

#### **13.2 OVERVIEW OF PROPERTY ISSUES**

The Agency's servicing goal is to protect the physical and financial asset that each project represents, and ensure that each project is operated in a way that meets program objectives. Sometimes, however, a property becomes troubled due to mismanagement, deferred maintenance, or market changes. As a result, the property may lose a significant share of its value. Whether a borrower chooses to abandon the property or to continue with its management, the Agency needs to address the situation created by the property's problems with appropriate servicing measures that protect the interest of tenants and the government. This section describes those measures.

In general, Loan Servicers should obtain the advice of OGC as needed for handling the special circumstances addressed in this section. These circumstances include:

- Abandonment;
- Valueless liens;
- Other security issues; and
- Taking additional security to protect Agency interests.

Prior to any decision involving real property under the special circumstances listed above, Loan Servicers will complete an environmental review under the National Environmental Policy Act, and a due diligence report. Refer to RD Instruction 1940-G, Environmental Program, and Chapter 3, Section 3 of the Loan Origination Handbook for further information.

### **13.3 ABANDONMENT**

When the Agency believes that a borrower has abandoned a project, it will make an immediate check to determine if the borrower has moved and, if so, whether a forwarding address can be determined so that further servicing actions can be taken. The Agency will take the steps necessary to protect the government's security interest in the property. In general, the steps taken following abandonment are similar to those taken following foreclosure, once abandonment has been confirmed.

#### **A. Indicators of Abandonment**

The Agency considers a property to be abandoned when any or all of the following conditions exist:

- The borrower cannot be located after the Loan Servicer has made diligent efforts to contact the borrower. This condition also applies to instances where the general partner(s) of a limited partnership cannot be located and the limited partners are unknown or cannot be located.
- The project remains unoccupied for an extended period of time and the borrower makes no effort to maintain the security property, secure eligible occupants, and/or comply with the objectives of the loan within a reasonable period of time as specified by the Loan Servicer in a certified letter sent to the borrower requesting compliance.

#### **B. Contacting Prior Lienholders**

If the property is not being maintained and the Loan Servicer determines that the borrower has abandoned the project, the Loan Servicer will attempt to contact any prior lienholders with a request that they take control of the property and make any emergency repairs necessary.

If no prior lienholder is involved or the prior lienholder cannot immediately be contacted or refuses to make the emergency repairs, the Loan Servicer will immediately notify the State Director and request permission to:

- Take possession of the property pending liquidation;
- Make health and safety repairs to prevent further deterioration of the security; and
- Enter into a management or caretaker's agreement on behalf of the owner.

#### **C. Making Emergency Health and Safety Repairs**

When making necessary health and safety repairs where an emergency exists, Loan Servicers should recognize that the repairs need to be completed as quickly and effectively as possible. Accordingly, a "common sense" approach that balances the health and safety of tenants with the price, speed, and quality of the repairs should be employed. Bids for specific services may be obtained from several local contractors only

if the bid process does not adversely affect the health and safety of the tenants. Loan Servicers must document the circumstances leading to the emergency situation as well as the reasonable steps taken to address health and safety concerns in the case file, in order to later back up any costs incurred.

All costs incurred at the project during the interim period between abandonment and eventual disposition by the Agency – including repair costs – are the responsibility of the borrower. The Agency treats the costs of managing abandoned property as a recoverable cost item.

#### **D. Appointment of Caretaker or Management Agent**

A caretaker or management agent will normally be appointed when the borrower has abandoned the security property or has failed to maintain its operation and the State Director determines, with the advice of OGC, that the Agency should take possession of the property to best protect the interest of the government. Selection of a caretaker or management agent is subject to the following requirements.

- **Qualifications.** Persons or firms chosen as caretakers or management agents should have experience in operating and managing similar properties or have business experience that qualifies them to provide the needed services. They must be located near the property to provide day-to-day supervision, or be able to appoint a qualified local person to meet this requirement. Caretakers will normally be selected for unoccupied projects or those not suitable for occupancy. Management agents will only be selected for projects that are occupied or suitable for occupancy. The selection process—which must comply with all applicable Federal Acquisition Regulation (FAR) requirements—must be adequately documented by Loan Servicers in the official case file.
- **Allowable fees.** The amount of the management agent or caretaker fee must be set in accordance with Agency requirements for management fees. The requirements regarding management fees are established at 7 CFR 3560.102(i) and described in Chapter 3, Property Management, of the Asset Management Handbook. These fees will be paid as a project expense if project funds (i.e., reserve accounts) are available. If project funds are not available, fees will be paid with government vouchers, considered a recoverable cost, and charged to the borrower's account. The fees will be paid on a monthly basis.
- **Rental rates.** Rental rates at abandoned properties will normally remain the same for eligible occupants as when the project was under the control of the borrower, although revisions may be allowed under certain circumstances with the approval of the State Director. Such conditions include:
  - ◊ The lease agreement between the borrower and tenant permits changing the rates;

- ◇ A change of rates is needed to provide income sufficient to pay operational and maintenance expenses, including the caretaker's fee, and to repay the loan on schedule; or
- ◇ Any increase will not result in rental rates above the payment ability of eligible occupants, unless the State Director has given the authority to rent units to ineligible occupants.
- **OGC advice.** The State Director should consult OGC for advice, including the possibility of having a receiver appointed, when the following conditions exist:
  - ◇ The project is occupied but rent is not paid or collected;
  - ◇ The eligibility of the occupants cannot be determined; and
  - ◇ The borrower has failed to comply with the objectives of the loan within a reasonable time frame as specified by the Loan Servicer in a certified letter to the borrower requesting compliance.

#### **E. Addressing The Agency's Relationship With The Borrower**

To resolve the abandonment situation, the Agency must determine the cause of the abandonment. If a property is abandoned in accordance with Section 13.3 A of this chapter, Loan Servicers need to document that the Agency will proceed with one of three servicing options: foreclosure, acceptance of a deed in lieu of foreclosure, or debt settlement. The Agency normally will proceed with foreclosure unless one of the other two options is offered by the borrower. If the Agency determines after investigating the causes for the abandonment that the borrower entity is no longer viable, it will normally proceed to foreclosure or accept a deed in lieu of foreclosure, if debt settlement cannot be achieved. The Agency will consider negotiated debt settlement only in cases where a default is evident and doing so is in the best interest of the government. Properties in which debts are settled may be declared non-program properties.

Upon foreclosure, the Agency has the authority to seize any project accounts on which the Agency has countersigned (e.g., reserve accounts).

### **13.4 VALUELESS LIENS**

A valueless lien exists at a property where the recoverable value of the lien is less than the estimated cost of recovery. When the Agency determines that it has a valueless lien, it will prepare a written determination to that effect and release its lien.

#### **A. Declaring A Valueless Lien**

To declare a valueless lien, the Loan Servicer must provide the following submissions to the State Office:

- Identification of property (legal description);

- Description of the Agency's lien position;
- Documentation of reasons that lien is determined to be without value; and
- Explanation of the reasons for releasing the lien and a description of the type of release sought (i.e., partial or full).

#### **B. Documenting Valueless Liens**

To document the reasons the lien on a project is determined to be valueless and to devise a strategy for releasing the lien, Loan Servicers should take the following steps:

- Within the context of a problem case report, write up an assessment of the value of the project and forward it to the State Director for review and guidance on how to release the lien; and
- Follow State Office instructions, as applicable.

### **13.5 OTHER SECURITY**

The Agency also services other security instruments such as collateral assignments, assignments of rents, Housing Assistance Payments Contracts, and notices of lienholder interest in a manner indicated by the agreements and according to acceptable practices in the respective states. When other security is taken, the approval official should develop a plan for servicing it at the outset.

- The State Director should develop any special servicing actions with the advice of OGC to protect the Agency's interest.
- Loan Servicers should file evidence of the other security in the loan docket in the Field Office.
- The Loan Servicer should make a notation on the management system card showing that the security has been retained.

### **13.6 OBTAINING ADDITIONAL SECURITY TO PROTECT AGENCY INTERESTS**

The Agency generally does not need additional security to protect its interest. However, the Agency may negotiate with the borrower to obtain additional security in the form of real estate or other security when a decline in the value of the original security or other changes adversely affect the security available to the Agency in the event of a default. Examples of cases where the Agency may seek additional security include when the account is delinquent, the property has not been properly managed or maintained, or there is serious doubt that the borrower can carry out loan objectives.

While the Agency has the authority to seek additional security in the circumstances listed above, it is generally a negotiated, nonforcible action. However, there may be instances where the Agency can use its leverage to obtain additional security (e.g., a case where loan funds are

used to purchase land on which the borrower plans to build a parking lot). In such cases, the Agency might demand an interest in the parking lot as additional security for the entire project. Additional security is taken by executing a deed of trust with the borrower.

#### **A. State Director Authorization**

In cases where taking additional security is warranted, the Loan Servicer must forward the borrower's case file to the State Director for authorization, along with a memorandum providing the following information:

- The facts that justify the taking of additional security;
- A conservative estimate of the market value of any real estate to be mortgaged. Note: It is not necessary to obtain an appraisal of the property to be mortgaged unless required by the State Director;
- A brief description of any existing liens on the additional security, including the repayment terms and the unpaid balance;
- The name of the title holder and how the title to the property is held. Note: Title evidence is not required;
- A plan for servicing the additional security to be taken; and
- A description of other servicing alternatives available to ensure that the objectives of the loan will be met and to protect the government from loss.

The highest quality security available should be taken whenever additional security is considered. This means that if several security options are available, the option that has the least amount of risk associated with it (and would thus be easiest to liquidate if necessary) should be chosen. Security property with known environmental hazards or other risks generally should not be taken as additional security. Such risks will generally be identified when the Loan Servicer conducts due diligence, including an environmental review. When the Agency chooses not to acquire additional security property, whether in whole or in part due to the presence of or potential for release of hazardous substances or petroleum products, the Loan Servicer will notify the appropriate regulatory authority of the Agency's findings and actions.

#### **B. OGC Advice**

Loan Servicers should obtain OGC advice and assistance whenever additional security is taken. Specifically, OGC can provide a title opinion, which will advise Loan Servicers as to what lien position is available to the Agency.

**13.7 SECURITY ISSUES INVOLVING PROJECTS WITH PARTICIPATION LOANS**

The Agency's rule states that when other participation is involved, the Agency will service the account in accordance with appropriate Agency servicing regulations and the agreements made with the other participants at the time of loan origination.

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## **SECTION 2: BORROWER ISSUES**

### **13.8 OVERVIEW OF BORROWER ISSUES**

Borrowers may occasionally experience special circumstances that affect their ability to operate the property and, thus, the Agency's approach to servicing their accounts. Bankruptcy, death, and divorce are events that require special attention to ensure that the interests of tenants and the government are protected. Similarly, special agreements that borrowers may have with members of the organization may affect the Agency's servicing approaches and decisions. This section addresses such special cases.

### **13.9 REQUIREMENTS FOR ADDRESSING BORROWER ISSUES**

The Agency will address borrower accounts affected by special circumstances such as death, bankruptcy, insolvency, and divorce on a case-specific basis. The Agency will make servicing decisions in such cases that are in the best interest of the government and tenants. The borrower or the borrower's representative will provide to the Agency information concerning the:

- Health status of the borrower and members of the borrower's family or organization, if applicable;
- Financial status of the borrower;
- Status of the security property; and
- Impact of the identified actions on the project's operation.

In general, Loan Servicers should obtain the advice of OGC as necessary to handle circumstances involving death, bankruptcy, insolvency, and divorce. Additional procedures for addressing deaths and bankruptcy cases specifically are found in RD Instruction 1962-A, Servicing and Liquidation of Chattel Security.

#### **A. Bankruptcy**

The handling of bankruptcy cases varies from state to state. Therefore, the State Director may issue State Supplements providing more specific guidance to expedite the handling of those cases. In general, however, Loan Servicers should obtain and follow the advice of OGC as necessary whenever general partners file for bankruptcy.

#### **B. Divorce**

When individual borrowers with loans are involved in a divorce action, the Loan Servicer will review the case after the final divorce decree has been granted to determine if any action is needed for the future servicing of the account. The Loan Servicer will submit the case file to the State Director for advice if the Loan Servicer is uncertain of the servicing actions needed to protect the Agency's interest, or if continuation of the

loan with the remaining borrower is not authorized. The Agency will not make subsequent loans to pay equity as a result of a divorce action.

### **C. Membership Liability Agreements**

As a loan approval requirement, some borrowers may have special agreements with members of the organization for the purchase of shares of stock or for the payment of a pro rata share of the loan in the event of a default. Alternatively, they may have instruments commonly referred to as individual liability agreements, which are usually assigned to and held by the Agency as additional security for the loan. In other cases, the borrower's note may be endorsed by individuals. The Agency will service these security and liability instruments in a manner indicated by the agreements to adequately protect the Agency's interest. The State Director will develop servicing actions with the advice of OGC.